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MEMORANDUM

TO: ASHOK MENON

FROM: SAMUEL LEVY

SUBJECT: LEGAL/ECONOMIC ADVISORY SERVICES FOR THE JOINT REVIEW/PRSC APPRAISAL

DATE: 30 APRIL 2004

During the period of 23 March to 6 April 2004, USAID, G14 development partners and the Government of Mozambique (the "GOM") met in Maputo to conduct a joint review for the development of the economy, the execution of the current state plan and state budget and performance against indicators in the PARPA (the "Joint Review"). In relation to the Joint Review, USAID requested certain legal and economic advisory services and, in connection therewith, a brief written report making recommendation for further USAID actions to improve the climate for the private sector. This memorandum is in response to that request.

The model on which donors, in theory, conduct their relations with the GOM may be labeled "performance-based governance." It is premised on a quid pro quo: if the GOM meets certain governance milestones, it gets more development assistance; if it doesn't, some fraction of that assistance is withheld. Among the many measures on which performance is judged is progress in improving the enabling environment for private sector activity.

While to our knowledge the various measures of performance are not weighed proportionately, it seems clear that the relative importance of the enabling environment for business to other measures, such as household poverty reduction and macroeconomic and political stability, is low. This may or may not be appropriate based on the relevant donors' objectives; after all, if the big picture is in focus, why quibble about small details? Mozambique has made notable progress in reducing the rate of household poverty and, as against many other Africa countries, has an enviable recent record of macroeconomic and political stability. Of course, to the extent one is concerned that growth in Mozambique be private-sector led in order to be sustainable, and that the profile of the private sector in Mozambique not be characterized disproportionately by a few large firms with special tax and customs privileges, donors should be very concerned about the enabling environment for business.

In practice, however, it is evident that the enabling environment for business is not a high donor priority. Witness the result of recent efforts in respect of regulations governing the employment of foreigners in Mozambique.

In that context, the private sector, through CTA, conducted a two year-long dialogue with the Ministry of Labor and produced a draft regulation (consensual in all but one important point) that was publicly announced at a seminar in December 2003. When the Ministry reneged on its commitment to that draft, CTA made a sound and timely economic and legal case, to all who would listen, for the liberal legislation it preferred. When it emerged that the final draft was substantially less liberal than hoped, CTA, with the encouragement of some donors, organized a campaign to encourage the Prime Minister to reconsider the regulation. Despite more than 200 letters of protest sent to the Prime Minister's office, CTA was not even granted an audience. The private sector then turned to the donors, hoping that they would intervene vis-à-vis the GOM in respect of this critical business environment issue. The donors, however, could not agree on a joint statement of even mild disappointment, and withheld all moral and political support to the private sector.

This episode, as well as others, suggests two conclusions. First, the enabling environment for business is not a high priority for most donors. Second, donors as a group will tend to the lowest common denominator of agreement in any joint approach to the GOM and, if there is no such denominator, do nothing.

Given the apparent inability of the private sector, at its most organized, to push a private sector reform agenda as against the GOM, and the unwillingness of the donors to do so, one is compelled to ask whether a strategy that gives priority to policy advocacy is likely to be successful. And this in turn begs the question of what alternative strategy to pursue. We believe there are three approaches that deserve consideration.

First, information is critical to empowerment. If businesses understand their legal and regulatory obligations and organize to meet them, they will not be -- and they will come not to feel – frequently surprised by the application of the law or exposed to its deliberate misapplication for corrupt ends. Strategies that maximize sound, reliable and timely information to the private sector will contribute to building an environment in which the rule of law prevails, and in which business can flourish.

Second, the rule of law requires that holders of rights are able to enforce them. This is not presently the case: it is the rare company indeed that is capable of confronting the State on questions of administrative law without fear of retribution (e.g. unwarranted tax audits, labor inspections, withholding of contracts). If the private sector were organized to litigate on principle for the benefit of all its members, it could use selected cases to determine principles (though not, unfortunately, to establish precedents) for the benefit of the private sector as a whole. There are instruments of administrative law in Mozambique that can be used for the purpose but rarely are, out of a mix of ignorance and fear. The private sector needs the benefit not only of advocacy, where the State has the discretion to accept or reject private sector positions, but also of litigation in the public interest.

Third, the enabling environment for business would improve if there were more competition in the realm of public services. One example of this is private arbitration which, when well managed and properly priced, allows commercial disputants an alternative to the courts (for most purposes). This and other public goods, including

notarial services, customs warehousing and social security, can and should be supplied on a competitive basis. Still other public services can be outsourced, in whole on in part, to providers under contracts that link returns to performance. Examples of such instances, often referred to as public-private partnerships (PPPs), include judicial execution, management of registries and, most obviously, public utilities.

In sum, recent experience has shown the limits of private sector advocacy and the unreliability of donor pressure as means of impelling policy change. As complements thereto, the foregoing three approaches – increased information, public interest litigation and increased competition in the provision of public goods, through PPPs – deserve more considered attention.

Please feel free to contact me with any questions or comments you may have in respect of the forgoing.

SJL